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IN THE

SUPREME COURT OF UNITED STATES

OCTOBER TERM, 1940

NOS. 242 AND 243

IN THE MATTER OF THE REORGANIZATION OF PITTSBURGH RAILWAYS COMPANY, a Corporation, Debtor, and PITTSBURGH MOTOR COACH COMPANY, a Corporation, Subsidiary.

PHILADELPHIA COMPANY and Certain Underliers,
Petitioners,

v.

WALTER L. DIPPLE, JAMES P. McARDLE, BEN PAUL BRASLEY and THOMAS J. HOFFMAN, a Committee Known as the Tort Creditors' Committee, and CITY OF PITTSBURGH,
Respondents.

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRITS OF CERTIORARI

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CASES CITED

STATUTE CITED

CONSTITUTION OF THE UNITED STATES

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I.

COUNTER-STATEMENT OF THE CASE

Respondents agree in substance with the Statement of the Case contained in the petition for writs of certiorari under the heading of "Summary Statement of the Matter Involved" (pages 2 to 6) but desire to call to the attention of the court the following information with respect to certain items in the list of taxes involved in the case set forth in the footnote on page 4:

(1) The Federal Income taxes for the year 1937 became

due on March 15, 1938, although payment was permitted in quarter annual installments so that the balance due became payable on June 15, September 15 and December 15, 1938.

(2) The Federal Income taxes for the year 1937 withheld at source became due on March 15, 1938, although payment was not required to be made until June 15, 1938.

(3) The Pennsylvania corporate net income taxes for 1937 became due on April 15, 1938, although payment was not required to be made until May 15, 1938.

II.

COUNTER-STATEMENT OF QUESTIONS INVOLVED

1. Where Trustees of a street railways company in reorganization under Section 77B and Chapter X of the Bankruptcy Act are operating the business of the debtor, using in such operation not only the properties owned by the debtor but also properties belonging to underlying companies of the debtor, which latter properties have prior to the institution of reorganization proceedings been operated by the debtor under leases and operating agreements whereby the debtor has obligated itself to pay all the taxes which the said underlying companies are required to pay, which leases and operating agreements have neither been affirmed nor disaffirmed by said Trustees, should said Trustees be authorized and directed to pay the taxes against the underlying companies which accrued during the pe-

riod of operation of their properties by the debtor in possession and by the said Trustees when it has not been shown that the net revenues from the properties of each of the underlying companies realized during the period of operation by the debtor in possession and by the Trustees are sufficient to pay the taxes of each underlier?

2. Where the debtor street railways company, pursuant to leases and operating agreements whereby it operates the properties of underlying companies, has obligated itself, *inter alia,* to pay all the taxes assessed against the underlying companies, should the Trustees of the debtor in reorganization, who are operating the debtor's business, using in such operation not only the properties owned by the debtor but also those owned by the underlying companies, be directed to pay during the course of the administration in reorganization, before there has been a classification of the creditors of the debtor and before a plan of reorganization has been confirmed, the taxes against the underlying companies which accrued prior to the institution of the reorganization proceedings?

III.

ARGUMENT

The petition for certiorari raises questions with respect to two different groups of taxes, each of which involves different considerations. On the one hand there is a group of taxes of the underliers which accrued and the liability for which became fixed subsequent to May 10, 1938, the date of the filing of the petition for reorganization. On the

other hand there is a group of taxes of the underliers which accrued and the liability for which became fixed prior to the filing of the petition for reorganization although the time for payment had been deferred by permissive federal and state legislation until after the institution of the reorganization proceeding. Because of the different questions of law involved with respect to the payment of the two groups of taxes, the reasons assigned by petitioners for the granting of their petition for writs of certiorari will be discussed separately with respect to each of the two groups.

A.

Taxes which Accrued and the Liability for which Became Fixed Subsequent to the Filing of the Petition for Reorganization.

1. With Respect to this Group of Taxes the Decision of the Court Below Is Not in Conflict with the Decision of the Circuit Court of Appeals for the Second Circuit in Webster & Atlas National Bank of Boston v. Palmer et al., 111 Fed. (2d) 215, Decided April 16, 1940.

It is true that in the instant case the Circuit Court of Appeals held that the trustees of the debtor should not pay the taxes of the underliers whose properties are being used by the trustees under the debtor's leases and operating agreements, whereas in the *Webster & Atlas* case the court directed the trustees of the debtor to pay taxes legally assessed against the debtor's lessors while the trustees were operating the lessors' businesses. However, it is respectfully submitted that the fact situations of the two cases differ so substantially that they presented to the courts entirely different questions.

In the *Webster & Atlas* case, the trustees of the New York, New Haven & Hartford Railroad Company, debtor in reorganization under Section 77 of the Bankruptcy Act, were using in their operation of the debtor's business the properties of two lessors. Finding the operation of these lines to be unprofitable to the debtor, the court permitted the trustees to reject the leases. However, the lessors being unable to operate their own properties, the Court directed the trustees, pursuant to Section 77 (c) (6) of the Bankruptcy Act, to continue the operation of the rejected lines for and on account of the lessors. The trustees of the New Haven, finding that the rejected leased lines were being operated unprofitably and that the continued diversion of the New Haven's funds to meet the lessors' losses would prejudice the creditors of the New Haven, petitioned for authority to withhold the further payment of the lessors' taxes. The District Court granted the relief sought but the Circuit Court of Appeals reversed, holding that the Act of June 18, 1934, 48 Stat. 993 (28 U. S. C. A., Sec. 124a) hereinafter referred to as "Section 124a", required the New Haven's trustees to pay the lessors' taxes so long as they operated the lessors' properties.

In the instant case the trustees are operating only the debtor's business, using under certain leases and operating agreements the properties of the underliers. The trustees have not as yet either rejected or affirmed any of the leases and operating agreements. The Circuit Court of Appeals therefore refused to allow the payment of the underliers' taxes.

The facts of the cases, as well as the opinions of the two courts, clearly show that the two cases involved two different sets of questions. In the *Webster & Atlas* case, the Circuit Court of Appeals for the Second Circuit had to de-

termine (1) whether the trustees of the New Haven were operating the business of its lessors and thus became liable for its taxes, and (2) if they were liable for such taxes, whether the funds of the New Haven should be used to pay them. In the instant case the court below had to determine whether the debtor's trustees were liable for the taxes of the underliers together with the debtor's own taxes not by reason of the fact that they were operating the businesses of the underliers but by reason of the fact that they were alleged to be operating a unified transportation system made up of the commingled properties of the debtor and its underliers. The question involved in each case with respect to the primary problems of the trustees' liability differ so radically that whether or not the Court in the *Webster & Atlas* case erred, after holding that the trustees of the New Haven were liable for its lessors' taxes, in further holding that they were obliged to use the funds of the New Haven to pay the taxes, the two decisions are not in conflict.

The facts of the two cases thus present two entirely different situations with respect to the applicability of Section 124a. That section provides as follows:

> "SEC. 124A. STATE TAXATION: BUSINESS CONDUCTED BY RECEIVERS, TRUSTEES OR OTHER COURT OFFICERS SUBJECT TO
>
> "Any receiver, liquidator, referee, trustee, or other officers or agents appointed by any United States court who is authorized by said court to conduct any business, or who does conduct any business, shall, from and after June 18, 1934, be subject to all State and local taxes applicable to

such business the same as if such business were conducted by an individual or corporation: * * *"

Section 124a requires the trustees to pay only such taxes as are assessed against the business operated by them. Under the express wording of this statutory provision, the facts in the *Webster & Atlas* case may well justify the holding that the trustees of the New Haven are required to pay the taxes of its lessors. Upon the entry of the order directing the New Haven's trustees to reject the leases but to continue the operation of the leased lines for and on account of the lessors, the trustees ceased to use the leased lines in connection with their operation of the debtor's business and began to operate them as the separate and distinct businesses of the lessors. This was in accordance with the expressed Congressional intention that they should be so operated after the rejection of the lease, either by the lessor or, if the lessor was unable to do so, by the lessee. Inasmuch as the trustees were operating the lessors' businesses, they became liable for the lessors' taxes under Section 124a.

While the Circuit Court of Appeals for the Second Circuit could hold that Section 124a was applicable in the *Webster & Atlas* case by reason of the trustees' operation of the separate businesses of the lessors, the court below in the instant case was not called upon to make such a finding principally because it is an admitted fact in the case that the debtor's trustees are not operating the separate businesses of the underliers. On the contrary, the court below was requested to hold Section 124a applicable because the trustees were operating some fictitious unified transportation business resulting from their operation of the commingled properties of the debtor and its underliers.

This the court correctly refused to hold because it found that the trustees were only operating the debtor's business, using therein the properties of the underliers.

It is therefore respectfully submitted that the *Webster & Atlas* case and the instant case present two distinct situations requiring different considerations and different results insofar as the question of the respective liabilities of the trustees of New Haven and those of the debtor for the payment of their respective lessors' and underliers' taxes is concerned, and there is, therefore, no conflict between the decisions of the two Circuit Courts of Appeals.

2. In Holding that the Trustees of the Debtor May Not Make Payment of the Underliers' Taxes which Accrued and Became Due and Payable after the Approval of the Debtor's Original Petition for Reorganization, the Circuit Court of Appeals Did Not Decide Important Questions of Federal Law which Have Not Been, but Should Be, Settled by this Court.

(a) THE DECISION OF THE COURT BELOW DOES NOT RAISE AN IMPORTANT QUESTION WITH RESPECT TO THE EXTENT OF THE DUTY OF TRUSTEES APPOINTED UNDER THE BANKRUPTCY ACT TO PAY TAXES ASSESSED AGAINST THE BUSINESS OPERATED BY THEM

No question of the duty of the trustees to pay taxes assessed against the business operated by them arises in this case principally for the reason that respondents have fully conceded that it is the trustees' duty to pay such taxes. Respondents, however, have contended, and the Circuit Court of Appeals has held, that the underliers' taxes are not assessed against the business operated by the trustees. As used by petitioners the phrase "taxes assessed against

the business operated by them" has three possible connotations: (1) taxes assessed against the businesses of the underliers which are being operated by the trustees; (2) taxes assessed against the entire transportation system as a single business; or (3) taxes assessed against the business of the debtor company which is being operated by the trustees. So far as this case is concerned none of the mentioned possibilities presents a question of the duty of trustees in bankruptcy to pay taxes assessed against a business operated by them.

As to the first possible meaning of this important phrase, it is conceded that the trustees are not operating the businesses of the underliers. They have neither been authorized to operate the business of the underliers nor are they in fact operating them. In the order of their appointment (R. 107) the trustees were authorized, *inter alia*, "to preserve, maintain, manage and operate and keep in good order, condition and repair, the property and estate in possession of and/or owned by the debtor, and to manage and conduct its business". The authority of the trustees to conduct business is thus limited to the debtor's business. Furthermore, in their "Summary Statement of the Matter Involved" at page 3 of their petition for writs of certiorari, petitioners admit that the trustees have in fact been operating only the debtor's business, using in their operations the underliers' properties. The first meaning of the phrase therefore raises no question as to the extent of the trustees' duty to pay taxes assessed against the business operated by them.

Nor does the second possible meaning of the phrase, defining the business operated by the trustees as the entire transportation system of the Pittsburgh Railways System, present a question of the trustees' duty to pay taxes. Aside

from the fact that this view ignores the limitation upon the trustees' authority and petitioners' admission that the trustees have limited their operation to the business of the debtor, the acceptance of this interpretation compels the disregarding of the separate corporate entities of the underliers by holding that the underliers' properties are substantially in reorganization. This the Circuit Court of Appeals correctly refused to do. While the properties of the underliers are in the possession of the court and are being used by the trustees, the underliers themselves are not in reorganization and are not under the control and direction of the court. Moreover the very taxes sought to be paid arise solely by reason of the existence of the separate corporate entities of the underliers and bear no relation to their properties being used by the trustees or to the value of the properties to the trustees. Furthermore, the Circuit Court of Appeals felt that the previous history of the debtor which showed a course of conduct upon the part of both the debtor and the petitioners to insist upon their separate corporate identities made it inequitable to disregard them for the purpose of the present case (R. 149).

"Taxes are intensely practical", as stated by petitioners in their brief (page 20), but being practical, they do not ignore the realities of the situation. The acceptance of this second meaning of "business operated by the trustees" completely ignores the realities of the relations between the debtor and its underliers and brings into consideration a fictitious personality having no legal existence and without responsibility. The trustees were appointed for the debtor, to operate the debtor's business, and not for the entire transportation system although they are using properties owned by companies other than the debtor. It is submitted that no question of importance requiring the de-

cision of this court is raised by this contention or the refusal of the Circuit Court of Appeals to adopt it.

Nor does the third meaning of "business operated by the trustees" raise any question of the trustees' duty to pay taxes. This interpretation of the phrase defines the business being operated by the trustees as the business of the debtor and is consistent with the trustees' authority and with ptitioners' statement of the scope of the trustees' operations. It is the view adopted by the Circuit Court of Appeals. Under this interpretation of the phrase the trustees do have a duty to pay the taxes assessed against the debtor's business. The trustees would have a duty to pay the underliers' taxes only if they are assessed against the debtor's business and they would be so only if the debtor's liability for such taxes is a tax liability.

The Circuit Court of Appeals has ruled, and it is submitted, correctly, that the debtors' liability for the taxes of the underliers is not a tax liability but is a part of its contractual rental obligation. (R. 147). In arriving at this result the court was merely following its previous decision in *Philadelphia & Reading Coal & Iron Co. v. Van Deusen,* 103 Fed. (2d) 869, and the case of *Hardeman v. Hendrix,* 29 Fed. (2d) 738 (C. C. A., 5th Cir.). A similar conclusion was reached by the Circuit Court of Appeals for the Second Circuit in the case of *American Brake Shoe Foundry Company v. New York Railways Company,* 282 Fed. 523. No reported case to the contrary has been found. In view of the unanimity among the Circuit Courts of Appeals on this question, it is submitted no important question of Federal law requiring this court's determination is presented by this holding.

Having properly decided that the debtor's obligation for the underliers' taxes is only part of the contractual obli-

gation of the lease agreement, the Circuit Court of Appeals was correct in holding that the trustees should not pay the underliers' taxes until the court has determined the extent of the use of the underliers' property and the net earnings being derived therefrom or its value. In arriving at this conclusion the Circuit Court of Appeals made no new departure but followed the settled decisions of this court and other Federal courts. *United States Trust Co. v. Wabash Railway*, 150 U. S. 287; *Pennsylvania Steel Co. v. New York City Ry. Co.*, 198 Fed. 721; *American Brake Shoe & Foundry Co. v. New York Rys. Co.*, 282 Fed. 523; *Westinghouse Electric & Mfg Co. v. Brooklyn Rapid Transit Co.*, 6 Fed. (2d) 547; *In re Connecticut Co.*, 95 Fed. (2d) 311, cert. den. sub nomine *Connecticut Railway & Lighting Co. v. Connecticut Co.*, 304 U. S. 571. The opinion of the Circuit Court of Appeals well summarizes these holdings (R. 150):

> "The trustees have no obligation to pay the rentals due under the leases, as such, unless and until they affirm the leases and operating contracts. They have a reasonable time within which to affirm or disaffirm. During the interim their sole obligation is to pay the lessors a reasonable amount for the use and occupation of the properties actually in use. This rule, which was originally laid down in railroad receiverships in equity applies to the reorganization of a street railway under Section 77B of the Bankruptcy Act. If an interim payment is made it is ordinarily held that it should not be in an amount in excess of the net earnings derived from the operation of the lessor's properties."

The requirement that the net earnings of each under-

lier's property or the value of its use to the debtor's estate be shown before such payments can be made is a necessary corollary to the quoted rules. Prior to its present decision the Circuit Court of Appeals had already held in *Public Service Commission v. Philadelphia Rapid Transit Company*, 82 Fed. (2d) 481, that such interim payments could not be made until the requisite facts were shown. Certiorari was denied by this court sub nom. *Citizens Passenger Rys. Co. et al. v. Public Service Commission*, 298 U. S. 673.

It is respectfully submitted that the decision of the Circuit Court of Appeals does not decide any question of the trustees' duty relative to taxes assessed against a business operated by them by reason of the fact that the taxes of the underliers are not taxes assessed against the business operated by the trustees.

(b) THE DECISION OF THE COURT BELOW DOES NOT RAISE AN IMPORTANT QUESTION AS TO THE INTERPRETATION OF SECTION 124a.

What has been stated in the discussion immediately preceding applies with equal force to the instant question. In order for Section 124a to be applicable it must be shown (1) that the debtor's liability for the underliers' taxes is a tax liability, and (2) that the trustees have been authorized to operate or are in fact operating the underliers' businesses. As shown above the debtor's liability for the underliers' taxes is only a contractual obligation. As also shown above the trustees have not been authorized to operate the businesses of the underliers, nor are they in fact operating such businesses. Section 124a is therefore clearly not applicable and no important question of its interpretation is raised by the decision.

(c) THE DECISION OF THE COURT BELOW DOES NOT RAISE SERIOUS CONSTITUTIONAL QUESTIONS WHICH SHOULD BE DECIDED BY THIS COURT.

While some of the petitioners urged in the District Court that the refusal to pay the underliers' taxes was inequitable and permitted the diversion of the net earnings of the underliers to pay the tax obligations of the debtor, none of them has ever contended either before the Special Master, the District Court or the Circuit Court of Appeals that the refusal to pay the underliers' taxes would result in the taking of property without due process of law in contravention of the Fifth Amendment to the Constitution of the United States. The matter has been raised for the first time in the petition for the writs of certiorari. This court has held that it will not consider objections and assignments of error that were not raised in the courts below. *Burbank v. Bigelow,* 154 U. S. 558, *Saltonstall v. Birtwell,* 164 U. S. 54, *Lutcher & Moore Lumber Co. v. Knight,* 217 U. S. 257. The issue presented by this assignment of error could have been raised in either of the courts below.

But even if the matter is properly raised, it is submitted that no question of depriving the underliers of their property without due process of law is raised by the petition. The claims of the underliers for use and occupancy accruing during the period of administration are administration expenses and have the priority of such expenses. However, under the doctrine of *Michigan v. Michigan Trust Company,* 286 U. S. 334, and the companion cases cited in petitioners' brief, the tax liability of the debtor is entitled to priority over other administrative expenses and should be first paid as "the price that business has to pay for protection and security." Moreover, the Circuit Court has not

held categorically that the taxes of the underliers can never be paid by the debtor's estate. It has only refused to permit the payment on the basis of the record before it. The court has only held, as respondents have contended throughout the proceeding, that the trustees may not pay out moneys of the estate for claims for use and occupancy until the underliers have established their claims by showing in some manner the extent of the use and occupancy and its value. A decision which recognizes the propriety of the allowance if the claimant will establish its claim by competent evidence, as does the decis[illegible] the Circuit Court of Appeals, does not deprive a claimant of property without due process of law. On the contrary the Circuit Court of Appeals regarded the entry of an order, such as that of the District Court, directing the payment of the underliers' taxes without requiring the claims and the amounts thereof to be established, as having been entered without factual basis and as arbitrary and possibly confiscatory. Such an order would result in depriving *respondents* of their property without due process of law. The decision of the Circuit Court of Appeals does not therefore, it is submitted, raise any question under the Fifth Amendment to the Constitution of the United States.

For the foregoing reasons it is submitted that the petition for writs of certiorari in so far as it applies to taxes of the underliers accruing after the filing of the petition for reorganization should be denied.

B.

Taxes which Accrued and the Liability for which Became Fixed Prior to the Filing of the Petition for Reorganization.

What has been said before with respect to the taxes which accrued subsequent to the filing of the petition for

reorganization applies with equal force to the instant group of taxes. However, additional reasons exist why certiorari should be denied as to these taxes. The taxes involved are Federal Income Taxes for the year 1937 and Federal income taxes withheld at source for 1937, due and owing on March 15, 1938, and Pennsylvania net income taxes for 1937, due and owing April 15, 1938. As to these taxes the taxpayer had an option to pay them under the statutes at a later time, which was subsequent to the filing of the petition for reorganization on May 10, 1938. These taxes the Circuit Court of Appeals held were not administration expenses but items due and owing at the time of the filing of the petition. In arriving at this conclusion, the Court was in accord with this court in the case of *New Jersey vs. Anderson*, 203 U. S. 483, where it was held that the controlling factor is the time of the accrual of the obligation to pay rather than the time that actual payment is to be made. In the instant case the obligation of the underliers to pay these taxes had accrued and the debtor's obligation under its leases had also accrued. The claims of the underliers for the payment of these taxes were therefore only simple contract unsecured claims. Regarding the claims as unsecured claims no reasons exist for the granting of certiorari.

1. With Respect to this Group of Taxes the Decision of the Court Below Is Not in Conflict with the Decision of the Circuit Court of Appeals for the Second Circuit in Webster & Atlas National Bank of Boston v. Palmer et al., 111 Fed. (2d) 215, Decided April 16, 1940.

In the *Webster & Atlas* case the only taxes involved were taxes of the lessor accruing during the period of administration, all prior taxes having been paid, 111 Fed. (2d)

217. Insofar as the decision of the Circuit Court of Appeals in the instant case dealt with these taxes, it was treating with a question and subject matter not involved in the *Webster & Atlas* case and the decisions cannot be said to be in conflict:

2. In Holding that the Trustees of the Debtor May Not Make Payment of the Underliers' Taxes which Accrued Prior to the Filing of the Petition for Reorganization but Became Payable Thereafter, the Circuit Court of Appeals Did Not Decide Important Questions of Federal Law Which Have Not Been, but Should Be, Settled by this Court.

(a) THE DECISION OF THE COURT BELOW DOES NOT RAISE AN IMPORTANT QUESTION WITH RESPECT TO THE DUTY OF TRUSTEES APPOINTED UNDER THE BANKRUPTCY ACT TO PAY TAXES ASSESSED AGAINST THE BUSINESS OPERATED BY THEM.

Inasmuch as the debtor's liability for the underliers' taxes is only a contractual obligation, the claims of the underliers are not claims for taxes assessed against the business operated by the trustees and the trustees have no duty with respect to their payment other than to provide in a plan of reorganization for their payment in the same manner and to the same extent as other similar unsecured claims. Even, however, if the debtor's liability was a tax liability, the trustees would have no duty with respect to these taxes other than to provide for their payment in the plan of reorganization.

(b) THE DECISION OF THE COURT BELOW WITH RESPECT TO TAXES ACCRUED PRIOR TO THE FILING OF THE PETITION FOR REORGANIZATION DOES NOT RAISE AN IMPORTANT QUESTION AS TO THE INTERPRETATION OF SECTION 124a.

The purpose of Section 124a is to oblige a trustee who operates a business to pay the taxes assessed against such business during his operation. It does not purport to deal with all taxes owed by the debtor and it does not purport to deal with tax obligations of the debtor which accrued prior to the operation of the business under the direction of the court. The language of the statute itself discloses that insofar as the taxes now under discussion are concerned no question of the interpretation of Section 124a is involved.

(c) THE DECISION OF THE COURT BELOW WITH RESPECT TO TAXES ACCRUED PRIOR TO THE FILING OF THE PETITION FOR REORGANIZATION DOES NOT RAISE SERIOUS CONSTITUTIONAL QUESTIONS WHICH SHOULD BE DECIDED BY THIS COURT.

The decision of the Circuit Court of Appeals refuses to permit the payment of claims of certain of the debtor's unsecured creditors in advance of those of the other unsecured creditors but compels the payment of their claims to await the confirmation of a plan of reorganization which will provide for the participation in the reorganized debtor of all claimants entitled to participate therein. Such a decision does not deprive the underliers of their property without due process of law but is in entire accord with the bankruptcy powers conferred upon Congress by the Constitution of the United States, the Acts of Congress relating to Bankruptcy and the decisions of this Court.

It is submitted that the decision of the court below with respect to this group of taxes discloses no reason to move this court to grant writs of certiorari.

Conclusion

It is respectfully submitted that the Circuit Court of Appeals did not err in reversing the order of the District Court insofar as it authorized the payment of the underliers' taxes and that the decision of the Circuit Court of Appeals does not conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Webster & Atlas National Bank of Boston v. Palmer et al.*, 111 Fed. (2d) 215, and does not present important questions of Federal law requiring the decision of this court; and it is respectfully submitted that the petition for writs of certiorari should be denied.

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